CHEMONICS INTERNATIONAL INC.

NICARAGUA: ECONOMIC INCENTIVES, ASSESSMENTS, AND RECOMMENDATIONS

Nicaragua GBTI
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SECTION I: COUNTRY ECONOMIC ASSESSMENT

A. Overview

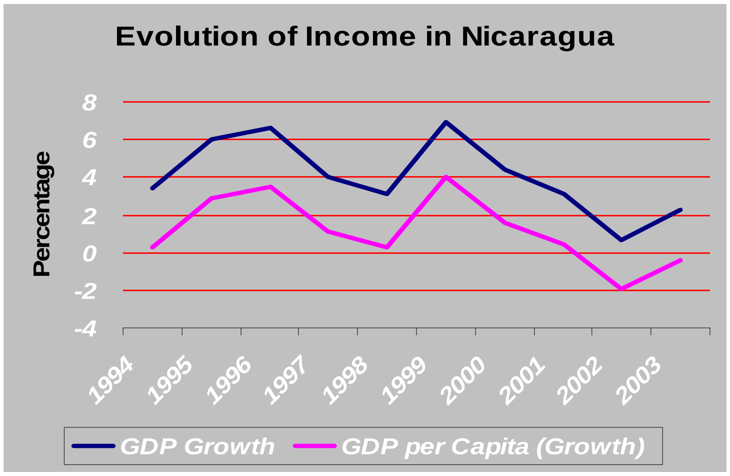
Nicaragua has witnessed a remarkable recovery from the dire fiscal situation that resulted from the 2001 collapse of half of the banking system. However, the improved macroeconomic environment has not resulted in accelerated economic growth and employment. The stabilization objectives have been achieved, but have not lessened the urgent need for an aggressive economic development strategy with the purpose of increasing economic growth and employment, and improving living conditions. Close to 55 percent of the economically active population in Nicaragua is facing either unemployment or sub-employment. To avoid further deterioration, the country needs to create at least 82,000 new jobs in 2004, a significant increase from the 18,000 and 50,000 jobs created in 2002 and 2003, respectively.

Likewise, the insecurity of property rights continues to represent one of the most serious limiting factors to investment, business development, and job creation in Nicaragua. It is urgent to invest in modernizing the registration system in the areas deemed to have potential competitive advantage to attract investment, to promote enterprise development, and to generate employment and economic opportunities for more people. Accelerating economic growth in the next few years will require (1) consolidation of macroeconomic stability, (2) an improved microeconomic incentive framework conducive to trade, business development, and investment, and (3) an improved property rights regime. Adherence to clear principles at the policy and competitiveness level is key to supporting a more active private sector, both domestic and foreign, that is willing to access new markets and take advantage of new opportunities resulting from US-Central America Free Trade Agreement (CAFTA)] and other recent trade agreements.

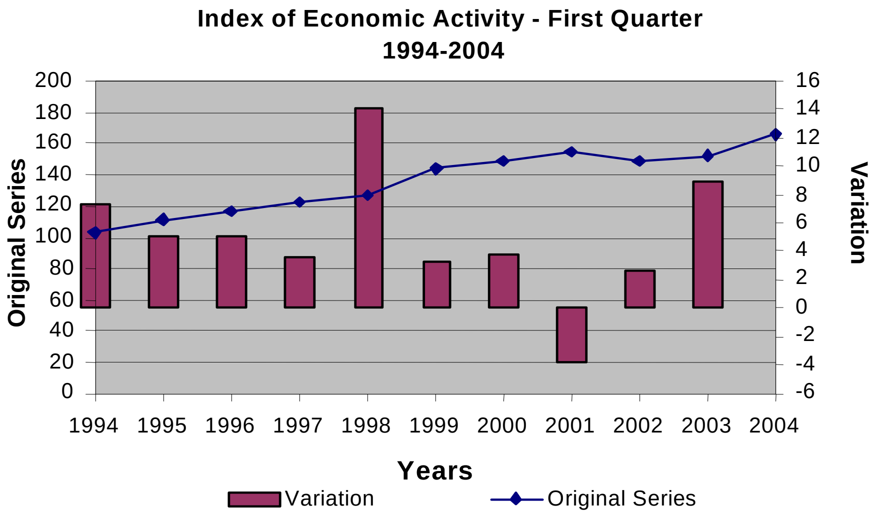
B. Economic Performance

B1. GDP Growth

During the year 2003 Nicaragua observed an important economic recovery. The country was able to change the downward trend, which has characterized economic performance since 1999 when the country reached a peak GDP growth of 7.0 percent. Last year’s 2.3 percent GDP growth, though modest, represents the first positive year-to-year gain since Hurricane Mitch reconstruction programs boosted performance in 1999. Unfortunately, real GDP growth on a per capital base continues to be below the observed population growth rate.



Economic performance remained strong during the first quarter of 2004. On a year-to-year variation, the Index of Economic Activity Indicator (IMAE) registered an increase of 8.8 percent as compared to an observed increase of 2.5 percent in the first quarter of 2003. This represents the second largest increase variation for a first quarter since 1994. The observed first quarter IMAE performance could indicate that the economy might demonstrate growth even above the IMF's projected rate of 3.7 percent for 2004.



Notwithstanding the slight recovery, Nicaragua needs to achieve significantly higher growth rates over the next five years to avoid setbacks that could place the country farther behind its Central American neighbors. Given the disproportionate number of new entrants into Nicaragua's labor market, a weak economic performance will likely result in more and faster emigration to Costa Rica and the United States. Furthermore, a failure to respond to people's number one priority—job creation—could lead Nicaragua down a dangerous path away from democracy and market-driven economy.

B2. Fiscal Sustainability

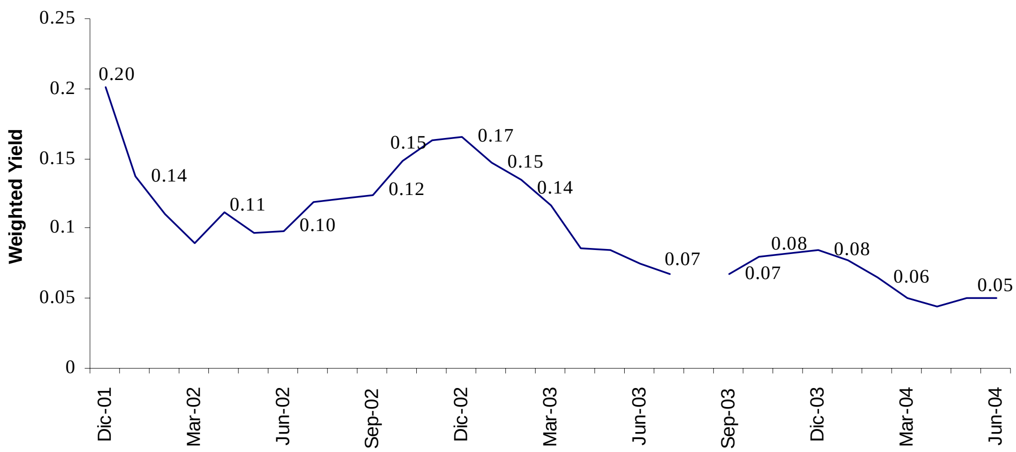
Fiscal recovery in 2003 was commendable. The Government of Nicaragua (GON) was able to continue the reduction of its combined public-sector deficit before grants, which has steadily decreased from 9.0 percent of GDP in 2001 to 4.3 percent in 2003. The main factors responsible for such fiscal improvement were: (1) a better handle on public spending, both recurrent and investment spending, and (2) a lower than expected capital expenditure schedule from the Transportation and Infrastructure Ministry (MTI), the Rural Development Institute (IDR), and other GON entities. The fiscal adjustment process is expected to continue in 2004 when the combined public-sector deficit after grants is expected to decrease to 1.8 percent of GDP.

The IMF has praised the GON for its commitment to fiscal reform and has now shifted focus from stability to consolidation. In this regard, a package of financial and fiscal sustainability laws is expected to be enacted during 2004, including: (1) a public indebtedness law, approved at the end of 2003; (2) a fiscal responsibility law; and (3) a law granting legal protection to the senior staff of the Bank Superintendence and the Central Bank, while conducting their official duties. Pension reform is being revisited given the anticipated significant fiscal deterioration effects that such a reform would have for Nicaragua.

B3. Monetary Policy

After two years of tight fiscal and monetary policy measures, Nicaragua is beginning to reap the fruits of its commitment. During the last quarter of 2003, the GON renegotiated $320 million of internal debt that had resulted from the 2001 financial collapse. This, in turn, resulted in lower interest rate payments on Central Bank certificates; an average decrease of 16 percent to 8 percent. It is anticipated that this negotiation will significantly improve the cash-flow basis beginning with the 2004 fiscal accounts, and allow for additional resources to be used for social-sector investment and additional infrastructure programs.

Weighted Yield of CENI and Nicaraguan Central Bank Paper



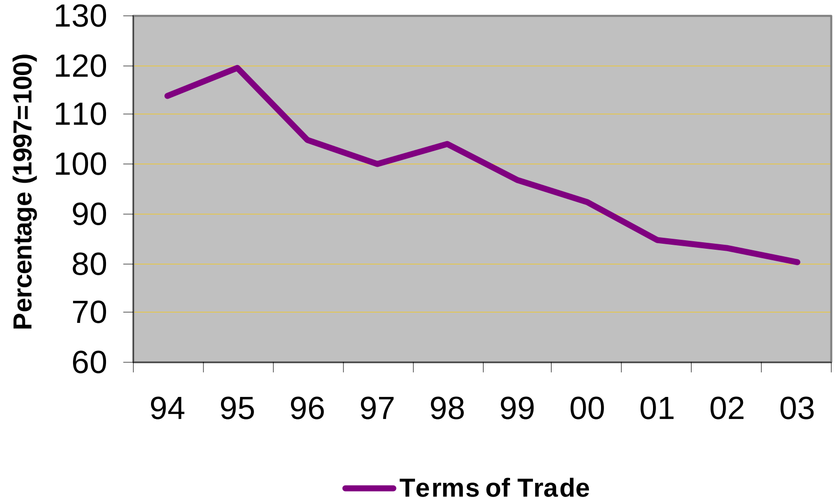
This significant reduction in interest payment has allowed the Central Bank to focus again on conducting sound monetary policy and to begin an orderly placement of standardized Central Bank certificates (CENIS). Accordingly, the weighted yield on 12-month Central Bank certificates has been steadily decreasing from a peak of 20 percent in December 2001 to less than 5 percent in June 2004. This remarkable performance stems directly from the country's commitment under the IMF-PRGF Agreement. This success is now allowing the GON to start replacing Central Bank papers for treasury papers for the first time, albeit in small quantities. These two significant results are laying out the basis for building a yield curve on Nicaraguan's government internal debt instruments, which are crucial to the development of capital markets in the country.

Exacerbated fiscal deficits and the need to finance them through internal debt has been one of the most important limiting factors to accelerated growth in Nicaragua. Nicaraguan banks found it more profitable to invest in Central Bank certificates, where they yielded an ample rate of return, rather than support productive activities. This pervasive incentive distorted the internal financial market, where only a hand-full of well-known players were able to finance their projects at competitive rates. Small and medium enterprises, on the other hand, were subjected to financial rates that exceeded that of the other countries in the region by more than 100 percent. The drastic decrease in interest paid for GON papers will put additional pressure on the banks in the short term to start directing more financial resources toward productive and innovative ideas in the country. Given the banks' lack of active participation in the productive sectors over the past three years, the strengthening of the sector's internal capacity to assess risk appropriately and to monitor productive sector performance is significant.

C. Consolidating Macroeconomic Stability

The GON has done a commendable job in restoring macroeconomic stability. Over the next five years, country's priority objectives are to sustain and consolidate recent progress, to achieve a medium-term growth rate capable of sustaining high levels of employment, and to facilitate the process of evolution toward a more equal society. Keeping inflation low, and ensuring social, economic, and environmental sustainability are central to achieving this objective. Continuing implementation of the IMF-Poverty Reduction and Growth Facility program will play an important factor in eliminating the fiscal deficit and ensuring a solid fiscal stance, improving economic predictability and significantly lowering perceived levels of economic uncertainty in the country.

One notable potential threat to the consolidation of Nicaragua's macroeconomic stability is the deterioration of the country's terms of trade. Over the last 10 years, Nicaragua has witnessed a deterioration of its terms of trade given the incapacity of the country to significantly expand exports and to move up the value chain. Country exports are still dominated by commodity trade with little value added, especially coffee and sugar, which have been affected by low prices globally. With imports representing three times the value of exports, the trade deficit continues to aggravate the situation and places continued pressure on the country's current account.



Building on sound fiscal and monetary policy, Nicaragua needs to strengthen its productive capacity by eliminating serious microeconomic constraints that create an environment of high risk for private investment. There is an obvious need to create operational programs as a roadmap within the National Development Plan. These programs must be implemented in the next four years. Shifting gears toward implementation would require coherent direction on multiple fronts, including:

- A new rural development program to provide clear incentives and a framework to promote integrated rural development to farm and non-farm enterprises by linking high potential enterprises to markets through domestic and foreign direct investment opportunities;

- An aggressive property formalization program to eliminate one of the most serious impediments to growth in Nicaragua;

- A better articulated investment promotion program focused on high-potential sectors such as the food industry, agribusiness, electronics, vertically integrated textiles, internationally traded services, and tourism;

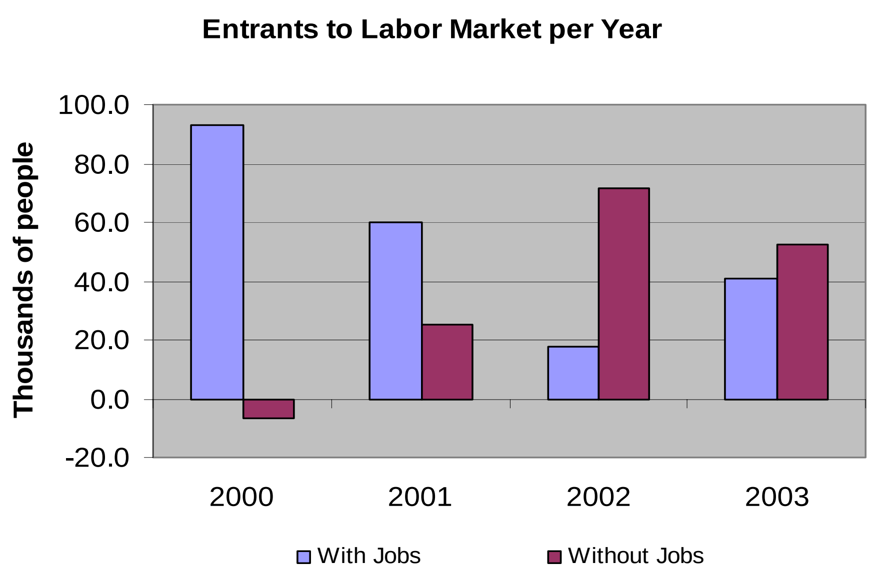
- The visualization and adaptation of existing transfer mechanisms as a basis for elaborating a broader equity policy in the country;
- Adopting a more proactive cluster development strategy to link local productive capacity more directly to market opportunities, attract investment, and foster value-added initiatives.

Macroeconomic consolidation cannot be achieved in the absence of a strong productive sector and a competitive, successful enterprise sector capable of taking full advantage of trade agreements and the new economic opportunities they create. A vibrant, successful enterprise sector is necessary if more than 2 million jobs are to be created in the next 17 years. To date, Nicaragua has had a poor record in promoting the creation of competitive enterprises. Moreover, the country has not shown strength in policy and program implementation. Accordingly, shifting the focus to the recommended directions, while difficult, could result in tangible economic gains for the population.

D. Labor Market Dynamics

Lack of job creation remains the most serious threat to economic progress and democratic development in Nicaragua. Half of the Nicaraguan population is under 15 years of age, which means that the country will have to create employment for all these new entrants to the Economically Active Population (PEA) who will demand jobs over the next 17 years.

Weak economic performance observed since 1999 has resulted in an inability of the labor market to absorb new workers, further exacerbating unemployment. According to GON figures, 18,000 jobs were created in 2002, compared to 50,000 in 2003. These statistics are far below the estimated 82,000 jobs per year that the country needs just to absorb those entering the labor market. In addition to new workers, some 400,000 Nicaraguans were facing unemployment or underemployment problems at the end of 2003. Hence, it is critical for Nicaragua to improve its economic performance significantly over the next five years to avoid further deterioration of the current precarious situation.



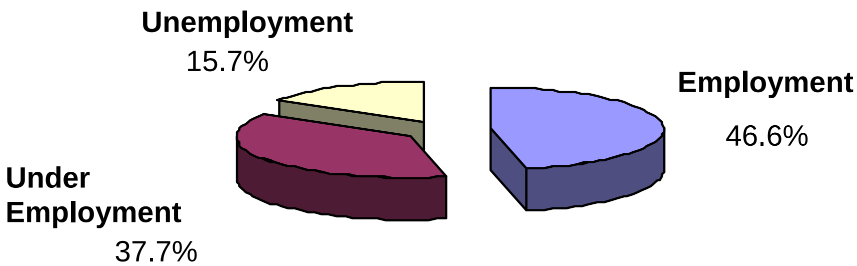
In 2003, Nicaragua's GDP grew at a rate of 2.3 percent, higher than the average growth of 1.5 percent for Latin America. This helped mitigate the negative influences that poor economic performance was having on the labor market. Nonetheless, the generation of employment in the formal economy remained weak. Most of the new jobs were created in low-end maquila operations in the textile industry and low productivity sectors. The percentage of people holding a formal job decreased from 37 percent in 2000 to 34 percent, while the percentage of people with informal jobs rose from 62.9 percent to 66 percent during the same period.

Table 1: Employment Dynamics in Nicaragua 1997-2002 (in Percentages)

Concept	1997	1998	1999	2000 (urban)	2000 (rural)	2001	2002	2003
EAP	52.3	52.5	50.6	52.8	54.8	49.8	49.4	50.0
Employment rate	87.2	89.9	91.1	91.7	96.3	88.7	87.8	84.3
Full-time job rate	52.2	53.3	57.5	54.9	49.0	54.9	52.4	46.6
Underemployment rate	35.0	36.6	33.6	36.8	47.3	33.8	35.4	37.7
Unemployment	12.8	10.1	8.9	8.3	3.7	11.3	12.2	15.7

Open unemployment rose to 15.7 percent of the EAP in 2003, while underemployment affected another 38 percent of the EAP. Hence, close to 55 percent of the economically active population faced employment problems in 2003. Moreover, the greatest concentration of underemployment occurs in Managua; women work in the worst conditions. Full-time employment grew at an annual rate of 1.4 percent between 1999 and 2001, which is significantly below the overall growth rate of the labor force.

Employment Status by Category in 2003



C1. Employment by Sector during 2003

In the construction sector, the number of employees decreased due to reduced investment in the private and public sectors. A similar situation occurred in the agricultural sector, which was deeply affected by the coffee crisis, and in the transportation, warehousing, and communications sectors due to the elimination of transport subsidies and the privatization of the phone companies.

On the other hand, the manufacture, hotel, and restaurant sectors showed improvement. New maquila operations in Chinandega, Leon, Granada, and Managua were responsible for most of the new jobs created in 2003. Likewise, an increase in the number of tourists helped create additional jobs in the hotel and restaurant industry.

C2. Salaries and Wages

Wage dynamics have varied significantly from one sector to another from 1999 to 2003 due to differences in marginal productivity. The highest real wage increases were observed in the electricity, water, commerce, hotels and restaurants, mining, and financial sectors. In contrast, real wages decreased within the industrial and agriculture sectors during the same five-year period. Average salaries in different sectors are described in Table 2.

Table 2: Average Salaries by Sector, 1999-2003

Sector	Year					Annual Change %	Real Annual Increase %
	1999	2000	2001	2002	2003		
Basic Salary (C$/month)							
Agriculture	600	716	680	721	759	6.4%	-0.1%
Mining	2,146	2,356	2,923	3,298	3,309	11.8%	5.3%
Industry	2,531	2,744	2,763	2,766	2,771	2.3%	-4.1%
Electricity & Water	2,216	2,470	2,767	3,375	3,989	15.9%	9.5%
Construction	2,012	2,283	2,328	2,375	2,813	9.0%	2.5%
Comm., Hotels & Restaurants	2,633	3,223	4,000	4,246	4,356	13.8%	7.4%
Transportation & Communications	2,747	3,325	3,621	3,625	3,627	7.5%	1.1%
Financial Sector	5,676	6,552	7,648	8,054	9,194	12.9%	6.4%
Services	2,187	2,492	2,720	2,789	2,877	7.2%	0.7%

C3. Food for Work and the Rural Labor Market

Food for Work is an important ingredient of the rural labor market over the last few years, especially in the northern region of the country. In 2003, the Department of Matagalpa was one of the areas most affected by food insecurity and natural disaster. Eight communities located in coffee production areas, including San Isidro, Sebaco, Ciudad Dario, and Terrabona, which are located in dry areas, as well as San Ramon, Tuma-La Dalia, Rancho Grande, and Matagalpa benefited from the food-for-work World Food Program activities. These activities were aimed at prevention, mitigation, and diversification in productive areas. The program assisted 4,795 families and with a total of 719,250 food rations over six months. Other food-for-work programs focused on road construction.

In the short term, food-for-work programs supplied much-needed nutrition to vulnerable, food-insecure areas, but in the medium term, such programs tend to created disincentives in the labor market. Accordingly, food rations offered through these activities should cover the minimum nutritional requirements to ensure that rural people have incentives to seek employment in their communities.

SECTION II: BUSINESS AND INCENTIVE FRAMEWORK

A. Business and Tax Incentives[1]

Nicaragua offers a wide range of tax and fiscal incentives to various exports, manufacturing, tourism, and other economic activities to stimulate investment in the economy and job creation. At the outset, the most important incentive for investors and the business community is the solid macroeconomic performance the country achieved over the last two year. A stable currency, low inflation rate, and decreasing interest rates throughout the economy are all contributing to an improvement in the business and investment climate. The most relevant tax and fiscal incentives at the sector-specific and microeconomic levels are described below.

A1. Income tax (IR)

- Legally constituted cooperatives are exempt from paying income taxes.

- Dividends and shares from business societies that contribute to income tax payments are exempt from income tax charges. Additionally, income tax is not applied to the interests of financial instruments with terms greater than four years, nor is it applied to interests or profits earned through authorized stock market activities by an individual living outside Nicaragua.

- When calculating net income, one can deduct the interest paid on third-party debts that have been invested in productive activities, plus any depreciation on productive assets.

A2. Value Added Tax (IGV)

- No payment of value-added tax is required on inputs and raw materials and intermediate goods used in industrial production of goods that are part of country's basic basket. Likewise, goods such as paper and machinery and equipment used by the media (print, radio, or TV) are not subject to this tax.

- All health-related services, including internal air, land, and marine transportation, as well as the energy supplied for irrigation in agricultural activities, are exempt from the value-added tax.

A3. Selective Consumption Tax (ISC)

No ISC is paid on fuel imported for energy generation purposes.

A4. Export Incentives

Export incentives include the suspension or devolution of rights and tariff taxes, as well as any other fiscal charge levied on imports, local sales, or gross revenue. These incentives also include

[1] Elaborated by Mr. Francisco Diaz from the Presidential Secretariat for Strategy and Coordination (SECEP).

any charge that increases the price of raw materials; intermediate and capital goods acquired by the exporter either through direct importation or local purchase of materials used in goods that have been directly exported or exported during the production stages of such goods.[2]

A5. Tributary Credit—Drawback

There is an established tributary drawback credit of 1.5 percent on the FOB value of exports, which compensates for any indirect tax paid by exporters and producers of goods in Nicaragua.

A6. Hospital Investments

Investments in hospitals are exempt from import tariffs. Additionally, selective consumption tax and value-added tax on goods deemed necessary for the construction, equipment procurement, and maintenance for the operation of the facility are also exempt. Likewise, no value-added tax is levied on local purchases of goods and services for construction.

A7. Financial Transactions

All financial transactions done through the stock market's authorized activities are free from fiscal and local taxes [3].

A8. Tourist Industry Incentives

1. Investment, construction, remodeling, and equipment procurements for the hotel industry

- Free from import tax and added value tax, for a 10 year period from the moment the enterprise begins its activities, when purchasing construction material, accessories, furniture, equipment, and vehicles;
- Exempt from real estate taxes for 10 years;
- Entitled to income tax write-offs of 80 to 100 percent(according to location and type of project) for 10 years;
- Given an exoneration period of 10 additional years, if the enterprise expands and/or renews a project.

2. Transportation enterprises (of all kinds) that contribute to the development of the tourist industry are entitled to exoneration of import tax and value-added tax when purchasing local equipment, computer and telecommunications equipment, and other materials related to the provision of transportation services for passengers.

3. Capital fund. The law allows the creation of capital funds for tourism-related investments by private financial institutions under the regulation of the General Bank Superintendence and other financial institutions that participate with investors in the different tourism projects.

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[2] All tributary credits related to gasoline and diesel is exempt.
[3] Profit obtained form sales, concessions, commissions, and services are excluded.

A9. Exoneration to the Productive Sector

Beginning January 30, 2005, all imports of inputs and goods that will be used strictly for the agricultural sector, and small artisan industries and fisheries will be exonerated from import tax. During this same period, all parts and accessories for machinery and equipment destined for these productive sectors will also be exonerated from the same tax.

A10. Free Zones

Enterprises in free-trade zones enjoy the following benefits:

- 100 percent exemption from income tax for the first 10 years of operation, and 60 percent exemption starting the 11th year[4] and beyond.
- Tax exemption for the establishment, transformation, incorporation, and reform of free-trade zones enterprises as well as for duty or revenue stamps.
- Exemption from all customs-related levies and taxes and from all import-related consumption taxes normally applicable to the introduction of imported goods, needed for the normal operation of these enterprises.
- Total exemption from indirect sales or selective consumption taxes, municipal taxes, and export taxes for products manufactured in the zone.

A11. Coffee Industry Promotion and Development

- Up to 50 percent of costs for acquisition of machinery and equipment for production and processing of coffee will be deducted from the base income tax, as well as any other costs associated with social infrastructure (i.e. living quarters) destined to provide better living and job conditions for employees.
- Whenever the price of coffee on the international market falls below US$100 per 100 pounds[5], producers do not pay income tax.
- Producers that reinvest their annual profits to expand and renew their coffee plantations or that invest in forestry can deduct 20 percent of their total investment from their income tax for the corresponding fiscal period.
- A Promotion and Development Coffee Fund (FOCAFE) has been established with all the funds producers have not claimed under the tributary drawback system.

A12. Indirect Incentives

Beside the wide range of exoneration mechanisms benefiting various economic activities and sectors outlined, Nicaragua also offers a series of indirect transfers to sugar, rice, bean, corn, meat, and dairy producers. These transfers are possible given the special tariff regime that governs these productive activities. Sugar and rice receive more than 50 percent of these income transfers.

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[4] Does not include personal income, salaries, and wages paid to national or international personnel.
[5] Contract "C" value from the NYSE

It is estimated that as much as US$104 million per year is transferred from consumers to these producer groups. This is equivalent to 2.5 percent of the national GDP and represents a significant negative income transfer within the society.

B. Property Rights in Nicaragua

A clearly defined property rights system is a foundation for democratic market economies, allowing property owners to capitalize their assets in pursuit of economic opportunity. This is not the case for Nicaragua, where property rights are poorly defined and enforced, which represents one of the most serious sources of risk and uncertainty for local and foreign private investors in the country.

A recent IMF study on the connections among uncertainty, transparency, and institutional strength and investment confirms that investors command a higher risk premium in those countries with higher levels of uncertainty, a lack of transparency, and a weaker institutional framework. Hence, only investments of greater than normal risk or that are based on a low cost structure will be attracted to an institutionally weak country. With less institutional strength, uncertainty is greater over time. Therefore, even potentially productive investments will not be undertaken, resulting in lower job growth and reduced economic opportunities for the entire population.

Indeed, property insecurity is one of the main reasons why Nicaragua has remained the third worst country in the Western Hemisphere in attracting foreign direct investment to productive sectors such as light manufacturing, food, agribusiness, tourism, and housing. Moreover, the high levels of insecurity partially explain Nicaragua’s relatively poor position and lack of economic opportunities for young people who seek a better future by emigrating to Costa Rica and the United States, both legally and illegally.

B1. Describing the Property Problem

While Nicaragua has achieved a relatively high rate of land titling in the past 10 years,

- Approximately 70 percent of the productive land units are affected by some sort of land tenure irregularity;
- Almost 40 percent of all rural properties still have multiple titles;
- Only 20 percent of the land is covered under a modern registration and cadastre system;
- Land is underutilized, which corresponds to mediocre productivity levels and failure to reach full economic potential;
- Nicaragua has had an average inflow of US$136 million per year in foreign direct investment since 1990, the third worst in Latin America;
- Lack of clear titles has severely limited credit resources to small and medium enterprises.

These facts reflect key problems affecting property rights in Nicaragua, including:

- A chaotic legal framework encompassing almost 50 pieces of legislation, which, at times, contradict each other;

- An unwieldy, non-transparent system of land tenure administration and formalization and a weak, institutional framework are dispersed over some 25 departments and agencies among the executive and judicial branches of government and civil society;
- Inefficient and ambiguous allocation of resources;
- A weak and obsolete public land register with high transaction costs;
- An incomplete cadastre system that encourages land conflicts.

B2. Expected Rewards of Improving the Property Rights Regime

Recent studies in Nicaragua have found that the propensity to undertake labor-intensive investments increases significantly with legal land title. Indeed, regularization and titling of property has been associated with a 30 percent increase in the value of assets, while the probability of undertaking additional investments increases by approximately 10 percent. The same study demonstrated the need to fix the registry system so that it is used more, improves the legal framework, and increases value through the use of collateral.

Additionally, secure property rights are the basis for:

- Creating an appropriate incentive framework for owners to make improvements to their property and to attract investment in new enterprises;
- Lowering transaction costs in land and capital markets;
- Increasing access to credit by providing more secure collateral;
- More fully integrating the underprivileged into the country's economic activities;
- Reinforcing participation in democracy and the rule of law.

B3. Improving the Existing Property Rights Regime

Improving the existing property rights conditions in Nicaragua will require a series of actions in several parallel fronts, including legal/institutional, operational and financial.

B3.1 Legal and/or Institutional Activities

The GON has recently moved to address the property issue through a better institutional arrangement. IN that sense, the vice-ministry of Finance was converted into a "Property vice-Ministry" with direct reporting lines to the President, elevating the importance of the property issue within the government structure. It is expected that this new institutional structure will yield better results than the observed to-date as this new vice-ministry will retake property policy issues away from a low level division within the Agriculture and Forestry Ministry. Nonetheless, a series of activities will have to be undertaken to secure the anticipated benefits of an improved institutional framework, including:

- Strengthen the newly established Vice-Ministry of Property in a way that it could take a leadership position in addressing the property problem in Nicaragua;
- Conduct an outreach campaign on the need to resolve property rights issues, the negative impacts of land insecurity, and the overall game plan that will be used to attack the problem;

- Establish a broad training program for lawyers, notaries, bankers, registry staff, judges and legislators on property formalization issues, and needed property rights reform;
- Establish area-based process for land rights normalization.

B3.2 Operational Issue—Property Regulation Process

Likewise, it is necessary to take a series of operational actions that allow the reform process to move forward at an accelerated pace and that real economic benefits are achieved in the short and medium term, providing additional credibility to the reform process, in turn. Key operational activities could include:

- Create, in selected economic corridors, an efficient and reliable property registry, upgrading both human and information resources.
- Formalize real assets/tenure, ensuring that all property in the economic corridor is recorded. Facilitate the rationalization of enterprise structure in the agrarian reform sector (e.g., creation of share-stock corporations, register underlying landholding rights to individuals or cooperatives).

B3.3 Financial Issues

One important problem to resolve is that of land squatters in Nicaragua. Lack of formal mechanisms that increase access to land has been used as an excuse from political and economic interest groups to invade private properties throughout the country. Land invasion has been also supported by an effective and inefficient judicial system that is slow to respond on a timely basis to the claims of legal owners. One way to confront these problems is through activities such as:

- Provide appropriate mechanisms to facilitate finance for land acquisition (long-term purchase and short-term rental capital) to guarantee access to land and eliminate land squatters.

- Advocate for al resolution of all conflicts/claims in the targeted areas.

Property problems need to be addressed more systematically, focusing first on those high potential economic zones that could serve as the basis for spurring accelerated private-sector-led economic growth. This approach is particularly important for Nicaragua to be able to tap the potential benefits from CAFTA and other negotiated free trade agreements, and from its recent achievements in transparency and economic management. It is urgent to invest in installing a modernized registration system in areas with potential competitive advantage – to attract investment and promote enterprise development; and in turn, create employment and economic opportunities for more of its population. This means choosing selected geographic regions for priority investment in the establishment of the appropriate “infrastructure” of a property registration system.

SECTION III: LOOKING AHEAD

A. Adherence to Clear Policy and Competitiveness Principles

While significant progress has been achieved over the last decade, and especially during the last two years, Nicaragua will need to adhere to clear principles in order to improve the existing business and investment incentive framework; a crucial condition to accelerate growth and create the needed levels of employment. Accordingly, real improvements will be needed in the following areas:

A1. Economic Policy Level:

- Managing the public finances in a way that ensures sustainable match between resources and expenditure and that avoids imposing an unfair burden on future generations;
- Within a sound budgetary framework, maintaining a high level of infrastructure investment focused on improving the productive capacity of the economy;
- Promoting and maintaining competition across all sectors of the economy to ensure maximum efficiencies and lowest cost goods and services for the population;
- Ensuring that a proper balance between producer and consumer interests is at the center of policy making by promoting greater consultation and transparency in formulating legislation and regulation;
- Focusing on the quality and quantity of new and existing regulation (including enforcement) so as to minimize burdens, to reduce market entry barriers and to increase entrepreneurship and innovation.

A2. Competitiveness Level

- Regaining and sustaining Nicaragua’s competitiveness in its cost dimension and in all the other dimensions;
- Establishing appropriate regulatory arrangements for the economy which are designed to achieve competitiveness gains while safeguarding the public interest, in particular with regard to maintaining services of general interest and the need to ensure infrastructure investment;
- Addressing structural deficits and supply side weaknesses that limit the capacity to achieve strong economic growth and thereby sustain high employment;
- Taking account of the need to reduce pressure on the environment and respect Nicaraguan’s international obligations; and
- Focusing on what is necessary to enable the economy to create and expand high value-added economic activity, while accelerating jobs creation and economic diversification, especially in the rural areas of Nicaragua.

Sources:

1. IMF Poverty Reduction and Growth Facility (PRGF) Progress Report May 2004
2. Ministry of Labor (MITRAB) surveys. 1996, 2000
3. Nicaragua Central Bank. Annual Report, 2001, 2002
4. National Institute of Statistics and Surveys (INEC). Employment Situation in Nicaragua, 1998-2001.
5. United Nations Development Program (UNDP). Nicaragua: Human Development Report, 2002.